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C O N F I D E N T I A L SECTION 01 OF 04 BUENOS AIRES 001892

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TAGS: EINV EPET ENRG ECON VZ AR
SUBJECT: ARGENTINA: FRUSTRATED EXXON-MOBIL PUTS ASSETS IN PLAY

REF: A. BUENOS AIRES 1819 AND PREVIOUS
¶B. 06 BUENOS AIRES 2598
¶C. CARACAS 1281

Classified By: Economic Counselor Doug Climan. Reasons 1.5 (b,d)

Summary

¶1. (C) After 96 years in Argentina, Exxon-Mobil is shopping its refining and retail assets. Company officials call this part of a region-wide "internal valuation exercise" that follows Exxon's recent decision to exit the Venezuelan market. It also reflects growing company frustration with a complex and distortive range of GoA market interventions that has made Exxon's Argentine operations only nominally profitable. Potential buyers of Exxon assets include prominent Argentine entrepreneurs (none with experience in the highly technical refining sector), Brazil's Petrobras and the GoA's own state-owned energy company ENARSA, perhaps in a joint venture with Venezuela's PDVSA. Exxon executives privately value the company's local assets in the US$ 1 billion range but acknowledge that the GoA has tools to constrain sale prices, including via spurious environmental liability assessments or by delaying required regulatory approvals. In contrast with its local competitor Shell, Exxon has maintained a low-key profile in dealing with the Kirchner administration's heterodox energy sector policy. A near-term Exxon departure from Argentina would be widely viewed as a no-confidence vote in the economic policies of a likely incoming Christina Fernandez de Kirchner administration. End Summary.

¶2. (U) With 2006 gross Argentine revenues in the US$2.1 billion range, Exxon-Mobil (Exxon) is primarily a "downstream" player in the domestic hydrocarbon market. It runs a single refinery that cracks crude oil purchased from local exploration and development companies (primarily Chevron and Pan American Energy) and markets refined products through a network of owned and franchised retail service stations.

¶3. (C) In early September, media reports surfaced that Exxon has engaged JP Morgan to explore the sale of its assets in Argentina. While Exxon's official position remains to neither confirm nor deny media reports of a pending sale, company officials admitted privately to EconCouns that the

company's U.S. headquarters has mandated a region-wide "internal valuation exercise" that reflects Exxon's recent decision to exit the Venezuelan market (Ref C) and growing frustration with GoA market interventions that make Exxon's Argentine operations only nominally profitable.

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Tangled Web of GoA Intervention in Energy Markets
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¶4. (SBU) In the aftermath of Argentina's 2001/2 economic crisis, Exxon's operations here have been affected by a complex and distortive range of GoA upstream and downstream hydrocarbon price controls. These include variable GoA hydrocarbon export restrictions, legal requirements that refiners fulfill local market demand before exporting, and high export tariffs on unrefined crude which set effective domestic price caps. (In May 2004, the GoA implemented a variable hydrocarbon export tariff system whereby crude export taxes jump from 25% up to 45% when the West Texas Intermediate benchmark exceed $45/bbl.)

¶5. (SBU) The bottom-line impact of such GoA interventions and controls on Exxon is that, although the company pays local producers only US$ 40-45/barrel for domestic crude (vs. global rates currently in the US$ 80 range), it is constrained to sell refined retail products domestically at rates roughly 50% below those of neighboring countries Brazil and Chile. Further, since 2004 the GoA has variably curtailed natural gas exports to Chile, a direct consequence of a GoA domestic energy pricing policy that makes domestic natural gas consumption considerably cheaper than alternative liquid fuels. Exxon notes that such unilateral GoA export

restrictions have created conflicts with Exxon's Chilean customers, put Exxon in legal jeopardy, and damaged the company's reputation as a reliable supplier.

¶6. (SBU) National refinery capacity limitations and domestic supply/demand imbalances for refined hydrocarbons have resulted in rolling diesel fuel shortages in Argentina over the past few years. Like other Argentine downstream refiners, Exxon has been forced by the GoA's re-introduction of a controversial 1970s-era "Supply Law" to import scarce diesel fuel and to supply it to local users at a loss. To date, Exxon has been able to compensate losses on diesel sales with profitable exports of surplus refined gasoline products. (Export tariffs on refined products remain a relatively low 5%, allowing Exxon to earn revenues on such exports at close to world market values). One of the reasons for an excess of gasoline supplies in the domestic market has been a series of GoA price incentives to convert gas-powered cars to run on compressed natural gas (CNG). Exxon estimates that such conversions have decreased gasoline demand by approximately 50% over the past six years. However, with over 500,000 new vehicles now being licensed in Argentina each year, market analysts project that surging local demand for gasoline will force Exxon and other refiners to forgo these profitable exports within two to three years.

Exxon Argentina on the Block

¶7. (C) The prospect of declining refined product exports, combined with general uncertainty about whether and at what pace the next GoA administration will ease government intervention and rationalize energy market pricing (Ref B), prompted Exxon to engage JPMorgan Chase to shop and value Exxon assets in-country as a preliminary step to considering a sale. According to media sources, the list of potential local buyers being scouted by JPMorgan Chase includes the same cast of characters identified earlier this year as interested in purchasing a minority stake in Argentina's largest and vertically integrated energy player,

Spanish-controlled Repsol-YPF (Ref E). Prominent among them are Jorge Brito of Banco Macro; Eduardo Eurnekian, head of the AA2000 airport concession; Marcelo Mindlin, head of the Pampa Group (Ref A); the Wertheim Group; and the GoA's state-run energy firm ENARSA.

¶7. (C) Exxon attributes leaks to the local media about its asset valuation exercise and to "unprofessional" conduct by JP Morgan Chase and ENARSA executives. They call local media reports of a $200 million sale price laughable, and estimate that Exxon's domestic assets are worth upwards of US$ 1 billion. However, Exxon executives acknowledge that the GoA has any number of tools to constrain a sale price. These include spurious environmental liability assessments and delaying or manipulating required regulatory approvals from the Planning Ministry Energy Secretariat, the Anti-Trust Authority (CNDC), and the GoA energy sector oversight regulatory entity (ENRE). As a case in point, Exxon executives noted the GoA's blockage in 2007 of U.S. investment firm Eton Park's purchase of a minority on regulatory grounds via a negative CNDC opinion.

Exxon's Non-Confrontational Style vs Shell's

¶8. (C) Like a number of other multinational energy sector players in Argentina, Exxon had filed an arbitration suit under the U.S. Bilateral Investment Treaty to recover financial damages resulting from the GoA's 2002 unilateral "pesification" of retail gas prices. Subsequently, in 2006, Exxon received an endorsement from ICSID to include additional damages incurred following the GoA's 2004 decision to curtail gas exports to Chile. Notwithstanding this ICSID suit, Exxon has generally maintained a low-key, non-confrontational profile in dealing with the Kirchner administration's heterodox and often combative energy sector policy. Local energy analysts contrast Exxon's style to that of Anglo Dutch-controlled Shell, whose confrontational approach has, over the past three years, earned it President

Kirchner's enmity. (At one point, Kirchner made a public appeal to boycott Shell's retail gas stations, and the GOA has issued heavy fines for supposed shortfalls of diesel fuel at these stations, and more recently closed its only refinery for 10 days on what many consider spurious environmental grounds. Exxon executives estimate that the temporary shutdown of Shell's refinery, required environmental upgrades, and GoA-imposed fines to date have cost Shell upwards of US$ 100 million.)

Views of Energy Sector Players

¶9. (SBU) Energy sector players in Argentina observe that the Kirchner administration has made a strategic decision to promote expanded direct state and private Argentine participation at the expense of foreign multinationals. To "encourage" foreign multinationals to cede control of energy assets, they say, the GoA has used its formidable regulatory oversight powers and heavy-handed market interventions to limit these companies' freedom of action and profitability. Over the past two years alone, energy majors CMS, Total and Electricite de France have departed the Argentine market, selling their assets cheaply to local interests (Ref A).

¶10. (C) Local energy analysts are watching developments closely and will take any low-balling of Exxon's asset value as a sign of overt GoA interference. Many question the wisdom of allowing local players with no experience in the highly technical refining sector to take over one of Argentina's most important refineries. One possible outcome could be a purchase of Exxon assets by recently created state-owned energy company ENARSA. Given ENARSA's burgeoning

cooperation with its Venezuelan counterpart PDVSA, another scenario could involve the Chavez administration seeking to purchase Exxon's assets in a joint venture with ENARSA as a means to gain a quick and strong retail presence in the Argentine market. Recetly, considerable media attention has focused on Brazil's Petrobras as an interested bidder on Exxon assets. Since Petrobras already has a refining presence in Argentina, GoA anti-trust approval could be a possible barrier to such a bid.

Exxon's Argentina Assets in Detail

¶11. (U) Operating under the Esso brand name, Exxon-Mobil was one of the first U.S. companies to establish operations in Argentina, arriving in 1911. It built the first Latin America refinery and was the first to process crude from Comodoro Rivadavia, in the Province of Chubut in Patagonia, whose oil fields were discovered in 1907. Today Exxon's Campana, Buenos Aires refinery is its most important in Latin America. With roughly 2,500 employees in Argentina (2,000 at the Campana facility), Exxon maintains a broadly diversified upstream and downstream presence here:

-- Downstream: The 88,000-barrel-a-day capacity Campana refinery, 50 miles northwest of Buenos Aires, produces unleaded gasoline, diesel, jet fuel, fuel oil, LPG and coke. (Argentina' refining market is dominated by Repsol-YPF, with six refineries. Petrobras has two, and Exxon and Shell each have one). Exxon also has a strong marine fuels business with a 21% market share, three jet fuel terminals at major airports with a 20% market share and direct 15,000 barrels-a-day sales to industry and wholesalers. Exxon owns a blending plant where produces 300,000 barrels-a-year worth of lubricants and greases for on-sale in Argentina and other Southern Cone markets. Finally, Exxon's 540 service stations (90 owned directly, the remainder franchised) hold a 13% domestic market share.

-- Chemicals: Intermediate hydrocarbon solvents (used in coatings, agro-chemicals, insecticides and adhesives) produced at the Campana refinery. Polymers sales feed the Argentine tires and adhesive industry. Vinyls (imported from Exxon Chile) feed the Argentine flexible PVC market.

-- Upstream: Exxon maintains interests in two onshore

natural gas fields: a 51% stake in Sierra Chata in the central Neuquen Basin, and a 23% stake in Aguarague in the northwest. Exxon markets its natural gas to a variety of local distribution companies, industrial users and power-generation companies in Argentina and Chile, primarily under long-term agreements.

-- Services: Exxon established a Buenos Aires Business Support Center that employs more than 400 skilled workers and provides back office services to affiliates in the Americas.

Comment

¶12. (C) Exxon's 96-year presence in Argentina has made its local "Esso" brand emblematic of this nation's highly developed automobile culture. Rumors that Exxon is shopping its Argentine assets, after having braved almost century's worth of Argentina's extreme economic volatility, have raised many eyebrows. Beatrice Nofal, head of the GoA's investment promotion entity, Prosper-AR, privately acknowledged a possible Exxon departure as "an Argentine investment climate public relations nightmare." A near-term Exxon departure from Argentina would be widely viewed as a no-confidence vote in the economic policies of a likely incoming Christina Fernandez de Kirchner administration.

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